FMC CORP.

IBLA 79-205 Decided April 14, 1981

Appeal from decision of the Acting Director, Geological Survey, affirming in part and reversing in part a determination by the Area Mining Supervisor that royalties payable under certain Federal sodium leases, Evanston Serial 021612 and Wyoming 053867, must be recomputed. GS-12.

Affirmed.

1. Mineral Leasing Act: Royalties--Sodium Leases and Permits: Royalties--Words and Phrases

   "Gross value at the point of shipment to market." The royalty rate for products mined and disposed under sodium leases must be imposed on the "gross value of the sodium compounds and other related products at the point of shipment to market," which means the gross value of a refined product for sale in an established market even when applied to an intermediate product and without deduction for the cost that would be incurred in producing a refined product.

2. Mineral Leasing Act: Royalties--Sodium Leases and Permits: Royalties

   Sales commissions are not an allowable deduction in the computation of royalty under sodium leases.

3. Administrative Authority: Estoppel--Federal Employees and Officers: Authority to Bind Government--Mineral Leasing Act: Royalties

   The Government is not estopped from requiring the recalculation of royalty

payments, even if it has accepted improper payments in the past.

APPEARANCES: Richard J. McNamara, Esq., FMC Corporation, Philadelphia, Pennsylvania, and Jerome C. Muys, Esq., Washington, D.C., for appellant.

OPINION BY ADMINISTRATIVE JUDGE HARRIS

FMC Corporation has appealed from a decision of the Acting Director, Geological Survey (Survey), dated January 3, 1979, affirming in part and reversing in part a letter-order issued by the Area Mining Supervisor, Salt Lake City, Utah, requiring FMC to recompute royalties payable under Federal sodium leases, Evanston 021612 and Wyoming 053867, and ordering FMC to initiate operating and reporting procedures to consider proper valuation of soda ash production consumed by FMC and improper sales commission deductions. The Area Mining Supervisor acted on the basis of an audit report compiled by the Office of Audit and Investigation, Department of the Interior. The audit covered the years 1972, 1973, and 1974, and for those years the auditors determined that appellant had (1) improperly valued the soda ash slurry produced at its Green River, Wyoming, plant and consumed at its adjacent sodium tripolyphosphate (STPP) plant resulting in a royalty overpayment of $ 15,497; and (2) improperly deducted sales commission expenses resulting in a royalty underpayment of $ 3,197. The auditors also found a nonrecurring inconsistency in computational procedure for the year 1973 which involved the use of an incorrect percentage rate in computing royalties due on a portion of sodium products resulting in an underpayment of $ 2,682 in Federal royalties.

During the audit period appellant produced and shipped approximately 2 million tons of soda ash and related products from leased Federal lands. Appellant consumed approximately 179,979 tons of soda ash as raw material feed to its STPP plant. The soda ash was extracted in slurry form from the main plant process prior to its final drying to finished soda ash.

In his decision the Acting Director found that for the audit years appellant had improperly valued the soda ash slurry it consumed in its STPP plant and that it had improperly deducted certain commissions in computing product value for royalty purposes. The Acting Director ordered appellant to recompute its royalty obligations for the period specified in the Area Mining Supervisor's order. That period was 6 years prior to the date of that order, August 26, 1976, excluding the years covered by the audit.

On appeal appellant asserts that it has been paying royalties under its sodium leases since production commenced in 1953. It alleges that during that time it has consistently valued its own consumption of soda ash slurry by multiplying the price of the finished soda ash by a factor which is the ratio of the costs of production up to the slurry

diversion point to total production costs. 1/ It also states that sales commissions have always been deducted from the sales price for the soda ash production shipped from Green River. Appellant contends that it openly communicated these methods of calculating royalty to Survey and that Survey never objected; that these methods survived a previous audit in 1966; and that the Area Mining Supervisor's letter-order was the first notice that its methods were improper. Appellant further asserts that even if it is determined the method of royalty calculation should be changed, it would be unfair and illegal to apply those methods retroactively and require recalculation for prior years.

[1] The pertinent statute requires that in the case of sodium leases the royalty rate shall be applied to the "gross value of the output of sodium compounds and other related products at the point of shipment to market" 30 U.S.C. § 262 (1976). This language is paralleled in the statute governing potassium leases. 30 U.S.C. § 282 (1976). The applicable regulation, 30 CFR 231.61 (1976), for both sodium and potassium, sets forth the royalty basis as follows: 2/

> The sale price basis for the determination of the rates and amount of royalty shall not be less than the highest and best obtainable market price of the ore and mineral products, at the usual and customary place of disposing of them at the time of sale, and the right is reserved to the Secretary of the Interior to determine and declare such market price, if it is deemed necessary by him to do so for the protection of the interest of the lessor. [Emphasis added.]

On the basis of the statute and regulation the Acting Director concluded that the Area Mining Supervisor properly determined that the soda ash consumed by appellant at the STPP plant should be valued on

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1/ This type of "work-back" formula was set forth in the "Memorandum Audit Report" dated Apr. 5, 1976, as follows:

> "Cost to refine trona ore to the slurry stage per equivalent ton of soda ash in solution / Cost to refine trona ore to a finished ton of marketable soda ash X Posted price/ton of finished soda ash, FOB Green River, Wyoming"

2/ The present language of 30 CFR 231.61 shifts the emphasis on setting royalty to the contract sales price. The safeguard insuring a fair return to the Government is reliance on the bona fide nature of the contractual transaction. Where there is no such transaction because the lessee is consuming the lease product certain factors are to be taken into account in setting royalty, namely: "(i) All prices received by the lessee in all bona fide transactions, (ii) Prices paid for commodities of like quality produced from the same general area, and (iii) Such other relevant factors as the Mining Supervisor may deem appropriate * * *." 30 CFR 231.61.

the basis of the gross value of finished soda ash sold from the Green River plant. The Acting Director indicated that this determination was supported by the decision in United States v. Southwest Potash Corporation, 352 F.2d 113 (10th Cir. 1965), cert. denied, 383 U.S. 911 (1966).

That case involved the valuation of crude potash ore sold exactly as it came from the mine. The court approved the Department's valuation of the ore on the basis of the gross value of the refined products of the ore and not the contract sales price for the ore, noting the broad range of discretion granted to the Department. The court construed the Department's interpretation of the terms of the statute applicable to determining the royalty base for potassium compounds ("gross value of the output of potassium compounds * * * at the point of shipment to market", 30 U.S.C. § 282 (1976)) to be gross value of the output of potassium compounds "as customarily sold in this area in an established market." Id. at 117. As the concurring opinion by Circuit Judge Seth pointed out, the customary market for crude potash ore was the refined product market.

In its statement of reasons for appeal, appellant attempted to distinguish Southwest Potash from this case by virtue of the fact that it involved the sale of a product at a stage of processing short of that customarily employed to make it marketable, as if the product had been fully processed to a marketable state. Appellant pointed out that in this case the mineral was consumed by the lessee in its integrated manufacturing facilities.

Appellant has pointed out a distinction without a difference. Judge Seth in his concurring opinion in Southwest Potash, supra at 118, recognized that the unusual nature of the royalty computation method, i.e., gross value at point of shipment to market, led to the problem presented in that case; however, he stated:

> The lease and the statute contemplate no alternative products for royalty purposes and no other market. Thus when the ore is severed it may be said that accountability for royalty then attaches, and it is not avoided by the diversion of the severed product prior to processing and marketing as was done in the case at bar. [Emphasis added.]

In this case the royalty attached when the ore was severed. The fact that soda ash slurry was diverted to appellant's STPP plant prior to its final drying to finished soda ash did not diminish appellant's royalty liability.

Neither soda ash slurry nor crude potash ore are products which are normally marketed. The usual and customary place of disposing of soda ash slurry at the time of sale is the finished soda ash market. Whether the soda ash slurry was sold, consumed, or otherwise diverted

prior to attaining the marketable soda ash state is irrelevant in terms of valuing the product according to its customary ultimate market. Thus, we cannot say that it was unreasonable for the Area Mining Supervisor to use the value of finished soda ash as the basis for computing royalty. Cf. Supron Energy Corp., 46 IBLA 181 (1980), appeal pending sub nom. Conoco v. Andrus, Civ. No. 80-0261M (D.N.M. filed April 7, 1980). Moreover, as the "gross value" of the finished soda ash at the point of shipment to market must be used, there can be no deduction for the cost that would be incurred in producing finished soda ash. See Foote Mineral Co., 34 IBLA 285, 301, 85 I.D. 171, 179 (1978), appeal pending, No. 12-78 (Ct. Cl., January 9, 1978).

The Area Mining Supervisor also disallowed deductions from the royalty base for sales commissions paid to appellant's distributors and brokers over the 3-year audit period. Appellant contends that while it is not entitled to deduct expenses necessary to make a lease product "marketable," e.g., ore processing costs and transportation costs to the point of shipment, inasmuch as a lessee must pay royalties on the basis of a marketable product, sales commissions are expenses "incurred in order to sell [soda ash] after it has been brought to a marketable condition." 3/ (Emphasis added.)

[2] Sales commissions have not been regarded by the Department as an allowable deduction in computing the gross value of a lease product to which royalty attaches. 4/ It is true that such expenses are not incurred in order to bring a lease product to a marketable state. However, having brought the product to such a state does not guarantee that all further expenses are deductible. While such items as freight handling from point of shipping to point of delivery to the customer were categorized as deductible in Assistant Secretary Chapman's

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3/ In a letter dated July 5, 1979, counsel for FMC Corporation retracted his arguments concerning foreign sales commissions made on pages 5, 7, and 8 of its statement of reasons. He states:

"FMC respectfully requests that the Board not address the issue of any special status for foreign sales commissions, inasmuch as the legal and policy issues FMC raises in its statement of reasons are not presented by the record in this appeal. FMC further requests that, if the Board rules adversely to FMC's basic contentions as to the deductibility of domestic and foreign sales commissions, it is noted that FMC's concern about the impact of mandatory use of foreign sales agents is premature and that the Board takes no position on that legal issue in light of the record before it."

4/ In a letter-decision dated Jan. 24, 1940, from Assistant Secretary Oscar Chapman to the Potash Company of America concerning an audit conducted by the Department, the Assistant Secretary indicated the deductibility or nondeductibility of 71 listed items. As to sales commissions, he specifically stated: "Sales commissions are company expenses and not deductible."

letter-decision (see n.4), items considered to be "company expenses" were determined to be nondeductible. Sales commissions are company expenses subject to the discretion of the seller, determined in part by the seller's convenience and sales program. The value realized by appellant through a commission sale is the value of the sales service and the monetary amount received. Therefore, appellant's deductions of sales commissions in the course of computing product value for royalty purposes was improper.

Appellant argues that any valuation policy which existed applied only to potassium leases and not to sodium leases. However, the Departmental procedure of administering sodium leases in accordance with principles involved in administering potassium leases is grounded on the language of the two statutes governing royalty payments for such leases, 30 U.S.C. §§ 262, 282 (1976). Both require that royalty be based on "gross value * * * at the point of shipment to market." The 1940 letter-decision of the Assistant Secretary stating that sales commissions were not deductible in computing royalty payments for potassium leases was directly applicable to sodium leases.

Appellant states further that to the extent Survey was attempting to impose a new valuation policy it could do so only prospectively. It urges that this is not a situation in which Survey's long term administrative construction of the proper royalty calculation under appellant's leases can be ignored as allegedly unauthorized acts of Government officials which conflict with the clear language of the statute or regulation. Appellant asserts that its practices were not clearly contrary to the statutory requirement because the two matters at issue were not treated in the statute.

We disagree. The fact that the statute did not specifically address the items of concern in this case is not decisive. In Foote Mineral Co., supra at 302, 85 I.D. at 180, the company produced and sold lithium carbonate from a brine containing lithium chloride and other minerals. 5/ A purchased lime reagent was added to the brine in order to precipitate minerals other than lithium. Soda ash was then added to combine with the lithium and produce lithium carbonate. While Foote Mineral had been deducting the cost of the lime reagent, Survey concluded, and the Board upheld, that the costs of the lime reagent were a processing expense for which no deduction was allowable (Stuebing, Administrative Judge, dissenting).

[3] Essentially the same argument asserted by appellant was pressed by Foote Mineral. It asserted that Survey was estopped from collecting royalties which accrued prior to the time Survey determined that its royalty calculations were incorrect.

5/ Foote Mineral Company was producing lithium products from brines leased by it under sodium and potassium leases. The decision contained a vigorous dissent stating that no royalty should accrue because lithium was a locatable mineral.

The Board held at 304 and 305, 85 I.D. at 181:

> The royalty rates are stated in the leases, and both the leases and the statute require that the applicable royalty rate be applied to the gross value of the sodium or potassium and other related products at the point of shipment to market. Acceptance of royalty on any other basis is contrary to statute and beyond the authority of this Department under the mineral leasing laws. Thus, the Government is not estopped from demanding royalty payments owed by lessees, even if it has accepted improper royalty payments in the past. Atlantic Richfield Co. v. Hickel, 432 F.2d 587, 591 (10th Cir. 1970), aff'g Sinclair Oil and Gas Co., 75 I.D. 155 (1968); Gulf Oil Corp., 21 IBLA 1 (1975).

While the doctrine of equitable estoppel has been applied against the Government, its application has been limited to cases where the affirmative misconduct of a responsible Federal employee would threaten to work a serious injustice, and where the public interest would not be damaged by its imposition. United States v. Ruby Co., 588 F.2d 697 (9th Cir. 1978); United States v. Wharton, 514 F.2d 406 (9th Cir. 1975); United States v. Lazy F.C. Ranch, 481 F.2d 985 (9th Cir. 1973); United States v. Georgia-Pacific Co., 421 F.2d 92 (9th Cir. 1970).

It can hardly be argued by appellant that the requirement of recalculation of royalty would create a serious injustice, or that it constitutes affirmative misconduct. The audit report concluded that during 1972, 1973, and 1974 appellant overpaid $ 15,497 for the soda ash consumed at its STPP plant and underpaid $ 3,197 because of the sales commission deduction. This indicates that appellant stands to receive a net credit against future royalty charges for the period of recalculation. See Shell Oil Co., 52 IBLA 74, 78 (1981). Even assuming a net deficiency, the doctrine would not be applicable. In such a situation the public interest would be damaged to the extent the public treasury was denied royalties due under the statute. 6/

6/ Appellant cites the case United States v. Lewiston Limestone Co., 466 F.2d 1358 (9th Cir. 1972) for the proposition that the courts have estopped the Secretary from retroactively assessing royalty deficiencies. Appellant's characterization is incorrect. Lewiston did not involve estoppel. The circuit court merely affirmed the district court's holding that the royalty provision in question was, as a matter of law and fact, vague and ambiguous as to the allowance of deductions and that the operators had properly deducted their expenses and had paid all royalties due.

Accordingly, pursuant to the authority delegated to the Board of Land Appeals by the Secretary of the Interior, 43 CFR 4.1, the decision appealed from is affirmed.

Bruce R. Harris
Administrative Judge

I concur:

Bernard V. Parrette
Chief Administrative Judge

I concur in the result:

Edward W. Stuebing
Administrative Judge